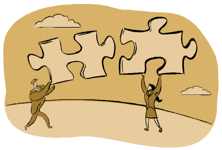

RETIREE HEALTHCARE: LEARNING & ENGAGING IN SOLUTIONS JANUARY/FEBRUARY 2008

GLOSSARY OF IMPORTANT TERMS

Note: Words defined elsewhere in this Glossary are shown in *italics.*

Actuary A professional or professional services firm that mathematically calculates the long-term future cost of benefit promises for plans like pensions and retiree health care.

Actuarial Report A report prepared by *actuaries* that provides details on assumptions and cost factors used in calculating the future cost of benefit promises. Some of the factors and assumptions used are: short- and longer-term expected health care cost increase trends, rates of investment earnings, participant turnover, expected longevity and disabilities of employees and retirees, effects of various benefits and *contributions* levels, impact of proposed cost controls, etc. Actuarial reports also provide the coming year's annual cost to properly fund the benefit promise as well as the total long-term cost for retiree health care. These amounts are called the *ARC (Annual Required Contribution)* and the *UAAL (Unfunded Accrued Actuarial Liability).*

ARC (Annual Required Contribution) *GASB* requires that employers obtain an *actuarial report* that shows how much money will be needed in the coming year to adequately pay for current and future retiree health care costs. This sum reported by the *actuary* is the ARC amount, and employers are required to report this ARC in their financial/accounting reports. But GASB doesn't specify whether the ARC has to be partially or fully *funded*. This partial vs. full *funding* decision is influenced by the stakeholder groups involved in each employer's retiree health plan.

Collectively Bargained Plan A plan with benefits provided as the result of good-faith negotiations between an employer and employee representatives, primarily unions. Terms are usually spelled out in a "collective bargaining agreement".

Contributions This term represents the amounts of money contributed (or paid) by the City of San Jose and active employees toward the cost of retiree health care. The total of contributions is the *funding* amount as defined below. The Municipal Code specifies that the City and employees share the cost of retiree medical care at 50% each.

FASB (Financial Accounting Standards Board) Independent, non-governmental organization that establishes the standards of financial accounting and reporting in the private business sector for the guidance and education of the public, auditors, and users of financial information.

Funded Ratio A ratio of the value of the benefits members have earned compared to the value of the retirement system's or trust's assets. While there are many acceptable methods of measuring assets and liabilities, GASB defines the *funded ratio* as the actuarial value of assets over the accrued liability.

Funding/Funded Funding is the process of generating enough money to pay for all retiree health care benefit promises. The funds necessary to pay for the cost of future retiree health benefits are contributed (funded) by employees and employers.

GASB (Governmental Accounting Standards Board) GASB is the independent, not-for-profit organization formed in 1984 that establishes and improves financial accounting and reporting standards for state and local governments. Its seven members are drawn from the Board's diverse constituency, including preparers and auditors of government financial statements, users of those statements and members of the academic community. The standards of financial accounting and reporting are intended to provide concise, transparent, and understandable financial information. More information about the GASB can be found at its website www.gasb.org. GASB sets the detailed standards by which public-sector employers like the City of San Jose must disclose all of their assets, liabilities, costs, etc. in their publicly-available financial and accounting reports. GASB Statements 43/45 require employers to disclose retiree liabilities for OPEB's (Other Post-Employee Benefits), and these OPEB's include other benefits like life insurance, dental, etc., but the primary OPEB cost driver is retiree health care. In the past, almost all employers have paid for their retiree health care costs on a *"pay-as-you-go"* basis. GASB has issued regulations and standards that now require employers to disclose how much their true future health care cost liability is, and also, to disclose how employers are going about paying for not only the current year's retiree cost, but more importantly, how employers are paying toward future retiree costs. This GASB-required retiree cost liability disclosure is similar to disclosure of pension liabilities

Medicare The federal health insurance program designed to provide health care for the elderly and the disabled. People who qualify for Social Security benefits are automatically eligible for Medicare. Eligibility for Medicare benefits begins at age 65 (or earlier in the event of certain serious disabilities).

Morbidity Incidence and severity of illness in a given population. Morbidity is taken into account by *actuaries* to help calculate the future cost of retiree health plans.

Mortality Rate The proportion of a population that dies during a specific time period. Mortality assumptions are used in calculating future costs of retiree health plans.

Pay-As-You-Go This benefit *funding* method has been in widespread use in the past to pay for current retiree cost obligations.. But this method considerably understates and under funds the true future liability for retiree health costs. This method only pays for retiree claims and administrative expenses incurred in the current year, and the method doesn't set aside any funds to pay for future years' costs. This method is also inconsistent with the principle that benefits should be paid for as they accrue like they are in pensions. In fact, in the pension sense, the pay-as-you-go method results in a 100% unfunded status for future retiree health care costs. The new *GASB* regulations don't prevent pay-as-you-go *funding*, but the new accounting disclosure requirements will show this method insufficiently pays toward the future costs for retiree health care costs. In addition, it is expected that continued use of pay-as-you-go may result in negative consequences even beyond not accumulating enough funds to pay for future retiree health costs.

Prevention, Wellness, Health Risk Reduction These are services designed to promote health and prevent disease. Examples include prenatal care, childhood immunizations, cholesterol screening, breast and cervical cancer screening, and diabetic retinal exams. These services also may include programs to improve fitness, better manage stress, improve nutrition, weight control and smoking cessation.

Retiree Health Savings Accounts (Trusts) Currently there are five models available to employers and employees for pre-tax contributions to retiree health care. They are:

- Health Savings Accounts (which require the establishment of a High Deductible Health Plan (HDHP)) and this is the only option of the five to permit employee pre-tax contributions.
- 401(h) Plans (which if combined with a pension plan cannot exceed 25% of annual pension contributions).
- Health Reimbursement Accounts
- Voluntary Employee Beneficiary Association *(VEBA)* Plan which requires the establishment of an oversight Board, usually a combined labor-management Board.
- Section 115 Integral Trust

Each of the five models permits per-tax employer contributions for employees (retirees are not eligible for participation). All models permit un-taxed investment growth and if used to pay eligible expenses in retirement (premiums, co-pays, 213 expenses) are non-taxed. The options permit eligible dependents (spouse, underage dependents) to continue to pay expenses upon the death of the participant, but if there are no eligible dependents, then funds revert to the plan or other participants in the plan.

Self-Funding/Self-Insurance A health care benefit financing technique in which an employer pays claims out of an internally-funded pool instead of paying premiums to an insurance carrier for coverage. The City of San Jose's pool for retiree health costs is called the "Medical Benefits Account" and this pool is included in the two Retirement Plans' accounts. The funds needed to pay self-funded retiree health cost claims are determined by *actuaries* and the *actuary's funding* recommendations are included in an *actuarial report*. The funds needed for the self-funding pool are contributed (*funded*) by employees and their employers according to *collective bargaining agreements* and separate agreements for non-represented employees. As an alternative to keeping funds in the Retirement Plan accounts, some employers use a *VEBA* instead (see definition below), and in this case, the retirees' claims are paid from the *VEBA*.

Social Security A federal government program that provides income support to people who are unemployed, disabled or over the age of 65 (or age 66+ for some future retirees).

UAAL (Unfunded Accrued Actuarial Liability) UAAL can best be described by using the following formula:

Total Future Liability for Retiree Health Care Costs For All Participants
Less: **Accumulated Funding Already Set Aside to Pay for Retiree Costs**
Equals: **The UAAL (the Unfunded Accrued Actuarial Liability)**

Almost certainly, no employer could pay off the full UAAL in a given year, so the UAAL amount may be spread out over as many as 30 years. Once the number of years to spread out the *funding* is decided by the Agency, the *actuaries* can determine the Agency's *ARC* (which is the **sum** of the coming year's expected retiree cost and the amount necessary to fund the UAAL over the specified number of years).

VEBA (Voluntary Employee Beneficiary Association) This separate-from-the-employer Trust Account is a tax-exempt benefit fund, regulated by the Internal Revenue Code, that pays specified benefits to members, dependents and beneficiaries. The VEBA is generally *funded* by employee and employer *contributions* and the funds, once deposited, can only be used to pay for the specified benefit promise. Investment earnings accumulate on a tax free basis in a VEBA.